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IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

GARY L. BRADLEY, JAMES D. GRESSETT, AND
CIRCLE C DEVELOPMENT CORPORATION
Petitioners,

v.

FIRST GIBRALTER BANK, FSB AND
FEDERAL DEPOSIT INSURANCE CORPORATION,
AS RECEIVER FOR GIBRALTER SAVINGS
Respondents

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

REPLY TO BRIEF IN OPPOSITION

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I. Summary of the Argument

The FDIC's Brief in Opposition to the Defendants' Petition for Writ of Certiorari is more notable for what it does not say than for what it does.[1]

The FDIC implicitly admits that federal jurisdiction under Article III does not exist in this case if the FDIC had no interest in the state court suit. That is, the FDIC does not dispute that an intervenor must independently satisfy the requirements of Article III. Nor does the FDIC dispute that § 1819(b)(2)(A) and (B) cannot be read to create Article III jurisdiction when the FDIC's intervention presents no case or controversy arising under federal law. Nor does the FDIC dispute that § 1819 is unconstitutional if it can be read in such a manner. Instead, the FDIC focuses its argument solely on whether the FDIC had an interest in the case. None of the three purported "interests" on which the FDIC relies supports Article III jurisdiction.

Similarly, the FDIC does not dispute that it could assign no greater rights to its assignee, the Bank, than the FDIC itself possessed. See FDIC Br. 10-11.[2] Instead, the FDIC attempts to rewrite the Fifth Circuit's opinion to hold that the Defendants waived all of their claims and defenses against the Bank. To the contrary, the Fifth Circuit plainly held that although the Defendants waived their claims against the Bank, they specifically reserved any defenses or offsets arising from the actions of the failed bank and its receivers. Nevertheless, the Fifth Circuit erroneously refused to apply state law on assignments, under which the FDIC could not have assigned any greater rights in the notes and guarantees at issue in this case than the FDIC itself possessed.

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[1]Abbreviations used in this brief are the same as those used in the Petition for Writ of Certiorari.

[2]References to "FDIC Br." are to the Brief for the Federal Deposit Insurance Corporation in Opposition.

II. Federal Jurisdiction Does Not Exist in this Case

The FDIC makes only one argument as to why federal jurisdiction supposedly exists in this case: it claims the FDIC had an "interest." *See* FDIC Br. 8-10. However, none of the three alleged "interests" on which the FDIC relies supports Article III jurisdiction.

First, the FDIC contends that it had an interest because the state trial court supposedly questioned the FDIC's authority to transfer assets of failed banks. FDIC Br. 4-5, 8. Notably, the FDIC does not cite the state court's order in support of its argument. *See id.* This is most likely because the state court never questioned the FDIC's *authority* to transfer assets. *See* R. 3509-3508. Rather, the state court merely held that a fact issue existed as to whether the notes and guarantees at issue in this case were *in fact* transferred to the Bank. *See id.* In so holding, the state court simply recognized that the testimony of the Bank's chairman and chief executive officer created a fact issue as to whether ownership of the agreements was ever transferred to the Bank:

> A: . . . We understood under the [acquisition] agreement that we would be an asset manager and that we would be working with the appropriate regulatory authorities in that regard. . . .
>
> Q: When you say you recognized you would be an asset manager, what -- what do you mean by that term?
>
> A: Well, we -- we basically managed the assets for what would be the beneficial owner, in this case, FSLIC, and that we would be required to manage them in -- in a fashion in which we would operate them in a way that would be efficient for the -- *the owner, which in this case was FSLIC.*

Tr. 1445-1443. In any event, the question whether *the FDIC* owned the notes was irrelevant to the issues before the state court. The issue was whether the Bank was entitled to summary judgment on the

notes and guarantees, despite the fact that it had denied owning the agreements at issue. The state court in no way suggested that it could somehow impose ownership of the notes on the FDIC. *See* R. 3509-3508. Nor did the Plaintiffs or the Defendants seek to impose any liability whatsoever on the FDIC. *See* R. 3372-3367, 3360-3351, 3234, 3232-3218. Indeed, it is difficult to discern how the FDIC's interests were at stake in the lawsuit at all, since the FDIC was not a party and therefore could not be bound by any order of the state court. *See Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 110 (1969). Accordingly, the state court's order could not have conferred on the FDIC an interest in this case.

Second, the FDIC argues that it had an interest in the case because the Defendants supposedly attacked the actions of the failed bank, "therefore raising issues of potential liability on the part of FDIC as Gibraltar's receiver." FDIC Br. 8. Once again, the FDIC fails to cite the actual pleadings filed in this case to support its argument. As a review of the pleadings shows, the Defendants never asserted claims or defenses against the FDIC or the failed bank for which it served as receiver. *See* R. 3234, 3232-3218. Nor has the Bank ever asserted such claims. *See* R. 3372-3367, 3360-3351. In a footnote, the FDIC apparently argues, as it did in the Fifth Circuit, that the mere mention of a failed bank in a pleading creates federal jurisdiction. *See* FDIC Br. 8 n.4; Reply Brief of the Appellee and Cross-Appellant, the Federal Deposit Insurance Corporation, as Receiver for Gibraltar Savings Association at 2-5 (filed in the Fifth Circuit on January 31, 1996); *see also* FDIC Br. 4. Once again, the mere mention of the failed bank and its receiver conferred no interest on the FDIC: the FDIC had not been sued and therefore could not have been bound by any judgment.[3] *See Zenith*, 395 U.S. at 110.

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[3]Moreover, the cases on which the FDIC relies do not support its position. *See* FDIC Br. 8 n.4 (citing *Nutro Prods. Corp. v. NCNB Texas Nat'l Bank*, 35 F.3d 1021, 1023 (5th Cir. 1994); *Bank One Texas N.A. v. Morrison*, 26 F.3d 544, 547 (5th Cir. 1994); *Pernie Bailey Drilling Co. v. FDIC*, 905 F.2d 78, 80 (5th Cir. 1990)). In *Morrison* and *Pernie Bailey*, the borrowers did not merely mention the actions of the failed bank, but rather actually asserted claims for damages against the failed

Third, the FDIC argues that the FDIC's guarantee that the Bank would realize a given rate of return on the notes gave the FDIC an interest in the litigation. FDIC Br. 8. But the FDIC does not dispute that such an indirect, consequential interest cannot support standing. *See Penda Corp. v. United States*, 44 F.3d 967, 972 (Fed. Cir. 1994), *cert. denied*, ___ U.S. ___, 115 S.Ct. 1962 (1995); Pet. 16-17. Nor does the FDIC dispute that it has never pleaded or proved that the success of the Defendants' defenses would actually -- or even probably -- push the book value of the loans below the rate of return guaranteed to the Bank. Any interest the FDIC has by virtue of its guarantee is therefore merely hypothetical and cannot support a finding of Article III standing.[4] In sum, none of the FDIC's claimed "interests" in this case can withstand even passing scrutiny.

The cases cited by the FDIC do not support the existence of federal jurisdiction in this case. *See* FDIC Br. 9-10 (citing *American Nat'l Red Cross v. S.G.*, 505 U.S. 247, 264 (1992); *Mizuna, Ltd. v. Crossland Fed. Sav. Bank*, 90 F.3d 650, 654-657 (2d Cir. 1996); *Buchner v. FDIC*, 981 F.2d 816, 818-819 (5th Cir. 1993); *FDIC v. Meyerland Co.*, 960 F.2d 512, 517-519 (5th Cir. 1992) (en banc),

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bank. *See Morrison*, 26 F.3d at 547; *Pernie Bailey*, 905 F.2d at 79, 80. Although *Nutro Products* is unclear as to exactly what the defendants' pleadings alleged, the court cited *Pernie Bailey* for the proposition that the FDIC is a proper party "in cases involving *claims for damages against [a] failed bank* . . . ." 35 F.2d at 1023 (emphasis added). To the extent that these Fifth Circuit cases can be read to support the FDIC's position, the cases, like the Fifth Circuit's opinion in this case, are simply wrong.

[4]Blatantly stepping outside the record, the FDIC also argues that it has, in its corporate capacity, acquired the notes and guarantees at issue in this case. *See* FDIC Br. 7. The FDIC, however, admits that this argument is irrelevant and cites nothing in the record to support this argument. *See id.* This unsupported, admittedly irrelevant argument is yet another attempt by the FDIC to manipulate federal court jurisdiction and should be disregarded. *See* S. Ct. R. 24.6.

cert. denied, 506 U.S. 1049 (1993); *Brockman v. Merabank*, 40 F.3d 1013, 1017-1018 (9th Cir. 1994)). These cases merely hold that Congress may confer Article III jurisdiction over actions involving federally chartered corporations. None of these cases holds that federal jurisdiction is proper over actions in which the federally chartered corporation has no interest in the case. *See id.* Indeed, one of the cases cited by the FDIC specifically reserved the question of whether the presence of the FSLIC would be insufficient to confer federal jurisdiction in a controversy unrelated to the FSLIC. *See Brockman*, 40 F.3d at 1016.

The FDIC, moreover, is simply incorrect when it asserts that it was not required to meet the requirements for intervention under Rule 24 of the Federal Rules of Civil Procedure because "[i]t is undisputed that the FDIC's original intervention was procedurally proper under Texas law." FDIC Br. 10. The Defendants have never conceded that the FDIC's original intervention was proper under Texas law. Rather, the Defendants have consistently pointed out that Texas intervention procedure requires two steps: (1) the intervenor files a petition in intervention, and (2) the other parties in the case are then permitted to test the propriety of the intervention by filing motions to strike the intervention, at which time the court engages in an analysis similar to that performed under the Federal Rule 24. *See* Tex. R. Civ. P. 60. The FDIC circumvented the second step by removing the case immediately after it filed its petition in intervention. Its intervention under Texas procedure was therefore incomplete and improper. *See id.* Because the propriety of the FDIC's intervention was never considered -- either by a state or federal court -- it is not properly "a party" to the case under § 1819(b)(2)(A) and (B), the only alleged basis for federal jurisdiction in this case. Accordingly, the Fifth Circuit's refusal to require the FDIC to meet the requirements for intervention permits the FDIC to evade the Article III requirement of a "case" or "controversy" "arising under" federal law.

III. The Court of Appeals' Holding Improperly Allows the FDIC to Assign Greater Rights than It Possessed

In their Petition, the Defendants argued that the Fifth Circuit created a special federal common-law exception to state law governing assignment when it held that the Bank is not subject to defenses arising out of the actions of the failed bank, the FSLIC, and the FDIC. Pet. 25-26. In response, the FDIC does not dispute that it could assign no greater rights to its assignee, the Bank, than the FDIC itself possessed. *See* FDIC Br. 10-11. Instead, the FDIC ignores a portion of the Fifth Circuit's opinion that allowed the FDIC to do just that, and incorrectly implies that the Fifth Circuit held only that the Defendants waived their defenses against the Bank. *See id.* A careful reading of the opinion reveals the FDIC's error.

The FDIC observes that the Fifth Circuit stated that the Defendants had waived their claims prior to November 3, 1988, as well as their "claims" against the Bank. FDIC Br. 10-11; Pet. A16. The FDIC argues that this holding also means that the Defendants waived all defenses against the Bank. This portion of the Court of Appeals' opinion, however, addresses only waiver of "claims" -- not waiver of defenses or offsets. *See* Pet. A16. If the FDIC had reported the rest of the Fifth Circuit's holding, it would have noted that the Court of Appeals further held that the Defendants *reserved* their *defenses and offsets* arising from the acts of the failed bank, the FSLIC, and the FDIC. *Id.* The Court also held, however, that the FDIC somehow assigned to the Bank the right to recover on the notes and guarantees free of these defenses:

> Under these provisions, Bradley and Gresset waived their *claims* against FGB and *reserved only those defenses or offsets arising from the acts of Gibraltar, the FSLIC, or the FDIC.* However, as FGB correctly argues, given the fact that Bradley and Gressett waived their claims against FGB and that they expressly and unequivocally acknowledge that FGB has no obligation to them to fund the project, *the rights reserved by Bradley and Gressett against*

> *Gibraltar, the FSLIC, or the FDIC would be meaningful only in a lawsuit against those entities; these rights are irrelevant in the instant case.*

Pet. A16.[5] Thus, under the Fifth Circuit's reasoning, the defenses to the agreements would be useless, as they could only be asserted against parties -- the FDIC, the FSLIC, and the failed bank -- who had already assigned away the right to enforce the agreements.

It is this holding that contravenes *O'Melveny & Myers v. FDIC*, ___ U.S. ___, 114 S.Ct. 2048, 2054 (1994). Under *O'Melveny*, the FDIC, acting as a failed bank's receiver, is subject to state-law defenses to the same extent as was the assignor-failed bank under state law. *See id.* at 2053, 2054. *O'Melveny* is consistent with state law holding that an assignee may receive no greater rights than those held by its assignor. *See* Pet. 26 (citing cases). In contrast, under the Fifth Circuit's holding, the assignee Bank is not subject to defenses that would have been good against the assignors (the failed

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[5]Indeed, the waiver agreement on which the Fifth Circuit expressly rests its holding plainly reserved the Defendants' right to assert defenses against the Bank based on the actions of the failed bank and its receivers:

> "[T]he Borrower and the . . . Guarantors each waives and releases any and all offsets, claims, defenses, or counterclaims of any nature whatsoever which any of them has or may have against [FGB], ***provided, however, that*** the Borrower and the undersigned Guarantors *reserve any defense or offset* (but not any other claims or rights) with respect to the enforceability of the loan Documents now held by [FGB] *arising from the acts or omissions of the Closed Association or of the FSLIC, acting in its capacity as receiver of the Closed Association, or any successor of the FSLIC acting in that same capacity. . . .*"

Pet. A16 (quoting Letter from First Gibraltar to Defendants at 3 (dated September 25, 1989)) (emphasis modified).

bank, the FSLIC, and the FDIC). The Fifth Circuit's opinion therefore conflicts with *O'Melveny*.[6]

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[6]The FDIC suggests in a footnote that the Defendants have no remaining claim in this case even if the Defendants did not waive their defenses against the Bank. FDIC Br. 11 n.7. The FDIC argues that the Defendants do not challenge the district court's finding that there was no default by the failed bank between the reinstatement agreement on November 3, 1988, and the failed bank's collapse on December 27, 1988. *Id.* Defendants were not required to challenge this finding, however, because the Fifth Circuit did not rely on it and, indeed, modified it. Unlike the district court, the Fifth Circuit did not hold that the failed bank had not defaulted; to the contrary, the Court of Appeals recognized the continuing viability of the Defendants' defenses that arose "during the period from November 4, 1988 to December 28, 1988, the date that FGB acquired [the failed bank's] assets." Pet. A16. The Fifth Circuit rejected the Defendants' defenses for a different reason: it held that the Defendants could not assert those defenses against the Bank, but rather could assert them only against the failed bank, the FSLIC, or the receiver. *Id.* This was the Fifth Circuit's holding as to the validity the Defendants' defenses, and the Defendants have challenged this holding in their Petition. *See* Pet. 25-26.

In any event, the Fifth Circuit correctly refused to follow the district court's holding that the failed bank did not default between the reinstatement agreement on November 3, 1988, and the failed bank's collapse. As shown in the Petition, the bank's collapse *was* the default, because at that time the bank and its receiver unequivocally and irrevocably repudiated its obligations to continue funding the Defendants' project. *See* Pet. 5.

Furthermore, the district court's suggestion that the Defendants defaulted on their notes has no support in the summary judgment record. Under the terms of the loan agreements, any alleged failure by Defendants to make an interest payment by December 1, 1988, did not constitute a default; instead, it constituted only an event of default. An "event of default" could not become a "default" under the loan agreement until written notice was given and Defendants were given ten calendar days to cure the alleged event of default. R. 1968. Thus, under the loan agreements, no breach exists until the Defendants fail to cure an event of default after receiving written notice. The Plaintiffs' own evidence confirms that the notice required to convert this alleged "event of default" into a "default" (*i.e.* a breach of contract) did not occur until April 18,

IV. Conclusion

Because the Court of Appeals' judgment conflicts with this Court's Article III jurisprudence, allows the FDIC to manipulate federal jurisdiction, and contravenes this Court's holding in *O'Melveny & Myers v. FDIC*, ___ U.S. ___, 114 S.Ct. 2048, 2054 (1994), the Defendants' petition for writ of certiorari should be granted.

Respectfully submitted,

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1989, at the earliest. *See* R. 3192. That was nearly four months after the failed bank had *wholly repudiated* the loan agreements by closing its doors and assigning away all of its assets. The repudiation having long proceeded the alleged default by Defendants, Defendants' performance was excused. A material issue of fact also existed as to whether the alleged lateness of the interest payment was waived by the Bank. *See* Corrected Brief of Appellants/Cross-Appellees (filed in the Fifth Circuit on October 31, 1995) (citing evidence).

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